Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Zettel and Kehoe	Analyst:	Darrine Distefano	Bill Number:	AB 294
Related Bills:	See Legislative History	Telephone:	845-6458	Introduced Date:	February 16, 2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Exclusion/Armed Forces Survivor Annuities

SUMMARY

This bill would exclude from income taxation all survivor benefits or payments received under several federal programs that provide benefits to survivors of deceased retirees of the armed forces.

PURPOSE OF THE BILL

The author's office has indicated that the purpose of the bill is to exclude the income received by a military retiree's surviving spouse and minor children under the Survivor Benefit Programs.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately. It would apply to taxable years beginning on or after January 1, 2001.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under federal and state laws, compensation received by a member of the Armed Forces is subject to income tax unless specifically excluded. Compensation received for any month while serving in a combat zone or qualified hazardous duty area is excludable. Qualified military benefits that are excludable from income include:

- benefits paid by the Veterans Administration, such as disability compensation, pensions, educational assistance, etc.;
- certain medical benefits, military disability benefits, and various travel allowances; and
- dislocation allowances, temporary lodging allowances, and move-in housing allowances provided for a permanent change of station.

Board Position:			Department Director	Date
____ S	____ NA	____ NP	Gerald H. Goldberg	03/26/01
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Under current state and federal laws, a member of the armed forces of any country and the uniformed services of the United States may exclude from gross income amounts received as a pension, annuity, or similar allowance for personal injury or sickness resulting from active service.

Under federal and state laws, gross income of a nonresident from sources within this state does not include any retired or retainer pay, received on or after January 1, 1996, as a member or former member of a uniformed service.

Under existing federal law, members of the uniformed services may elect to reduce their retired pay to provide an annuity to their survivors. Under federal and state tax laws, the reduction is excluded from gross income. Also, under federal and state law, annuities paid to survivors are included in the survivors' gross income for tax purposes.

THIS BILL

This bill would provide that gross income would not include benefits or payments received under the federal Retired Serviceman's Family Protection Plan, the Survivor Benefit Plan, and the Supplemental Survivor Benefit Plan.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

Prior law, Stats. 1943, Ch. 147, allowed a deduction from gross income for all salaries, wages, bonuses, allowances, and other compensation received for service as a member of the Armed Forces for taxable years 1943 through 1948 (World War II). Stats. 1952, Ch. 12, reinstated the World War II exclusion but limited it to $1,000 per year.

In 1971, Stats. 1971, Ch. 1, First Extraordinary Session, further limited the exclusion to compensation (other than pensions and retirement pay) received for service on extended active duty. For taxable years beginning on or after January 1, 1973, Stats. 1972, Ch. 1359, added an annual $1,000 exclusion from gross income for pensions and retirement pay as well as for compensation for other than extended active duty. However, this exclusion was limited to taxpayers with adjusted gross income of $17,000 or less.

AB 66 (Stats. 1985, Ch. 1461) increased the phase-out range to $27,000 for taxable years beginning on or after January 1, 1985. AB 4419 (Stats. 1986, Ch. 779) excluded from gross income up to $500 per month received for active duty service pursuant to a Governor-declared emergency. AB 53 (Stats. 1987, Ch. 1138) repealed each of these exclusions and established a tax credit, not to exceed $40 in any taxable year, based on various types of military income. The credit was repealed by its own terms effective January 1, 1992.

AB 1365 (Oller, 1999/2000), which failed passage in the Assembly Revenue and Taxation Committee, would have excluded from gross income any military retirement pay, military disability pay, or any other benefits received by a person retired from the armed forces. AB 2561 (Zettel, 1999/2000), which died in Assembly Revenue and Taxation Committee, would have allowed a credit for taxpayers who received retirement pay as a result of active duty in the armed forces. SB 1725 (Haynes, 1999/2000), which died in Senate Revenue and Taxation Committee, was identical to this bill.

OTHER STATES' INFORMATION

Massachusetts, Michigan, Illinois, New Jersey, and New York do not tax military pension income or survivorship benefits received from the U.S. uniformed services.

Minnesota taxes all pensions and annuities received as a resident of the state regardless of the source of that pension or annuity.

These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill is not expected to impact the departmental costs significantly.

ECONOMIC IMPACT

This bill would result in revenue losses as shown in the following table:

Estimated Revenue Impact of **AB 294** As Introduced February 16, 2001 With Enactment Assumed After 6/30/01 (In $Millions)			
Fiscal Years	2001/02	2002/03	2003/04
Revenue Impact (Rounded)	**($17)**	**($14)**	**($14)**

Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Revenue losses would depend on the amount of qualified military survivor annuity payments received in any given year for which state income taxes would otherwise be incurred.

According to available data from the Department of Defense, the amount of survivor annuities paid from specified federal retirement plans to California beneficiaries was over $287 million in 2000. This amount was indexed by 3% annually to project qualified payments for 2001 and thereafter.

This total amount was reduced 15% to allow for:

- current law exclusions for certain veterans' compensation; and
- recipients who do not incur enough income that require a state tax return to be filed.

A 5.5% average marginal tax rate was applied to estimate the state revenue loss (on the order of $14 million for the 2001 taxable year).

The 2001/02 fiscal impact reflects all 2001 losses plus 25% of the 2002 losses to allow for reduced estimated tax payments by some taxpayers.

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